



STATE BOARD OF EQUALIZATION STAFF LEGISLATIVE BILL ANALYSIS

Date Introduced:	02/23/01	Bill No:	SB 877
Tax:	Sales and Use	Author:	Poochigian
Board Position:		Related Bills:	

BILL SUMMARY

This bill would, among other things, provide a sales and use tax exemption for sales and purchases of cogeneration equipment, as defined, purchased for use on dairy farms.

ANALYSIS

Current Law

Under existing law, the sales or use tax applies to the sale or use of tangible personal property in this state, unless otherwise exempted or excluded by statute. Under current law, the sales and use tax applies to sales and purchases of farm equipment, including tractors, to the same extent as it applies to any other sale of tangible personal property that is not otherwise exempted or excluded from tax by statute.

The Sales and Use Tax Law provides some exemptions related to the agricultural industry, as follows:

- Tax does not apply to the sale or purchase of any form of animal life or seeds and plants of a kind, the products of which ordinarily constitute food for human consumption (e.g., sales or purchases of cows, bees, chickens, strawberry plants, and citrus seeds are exempt from tax).
- Sales or purchases of feed for “food” animals and fertilizer for “food” plants are exempt from sales and use tax.
- The sale and purchase of drugs and medicines administered to animals as additives to feed or drinking water are exempt if the primary purpose is to prevent and control disease of “food” animals or of animals which are to be resold.
- Other drugs and medicines, the primary purpose of which is the prevention or control of disease, that are administered to “food” animals are exempt.

Proposed Law

This bill would add Section 6397 to the Sales and Use Tax Law to exempt from the sales and use tax sales and purchases of cogeneration equipment purchased for use on dairy farms.

The bill would define “cogeneration equipment” to mean equipment used in the process of the cogeneration or transformation of dairy industry by-products into fuel or energy resources used for the operation of a dairy farm.

This staff analysis is provided to address various administrative, cost, revenue and policy issues; it is not to be construed to reflect or suggest the Board’s formal position.

The bill would define “dairy farm” to mean any place or premises upon which milk is produced for sale or other distribution, and where more than two cows or six goats are in lactation.

The bill would also add provisions to the Personal Income Tax Law that would allow a tax credit for the portion of property taxes paid on the congeneration equipment.

The proposed exemption would become operative on the first day of the calendar quarter commencing more than 90 days after the bill becomes effective.

In General

There are a wide range of animal wastes that can be used as sources of energy. The most common sources are manures from pigs, chickens and cattle (in feed lots) because these animals are reared in confined areas generating a large amount of waste in a small area. In the past, this waste has been recovered and sold as a fertilizer or simply spread onto agricultural land, but the environmental concerns over odor and water pollution means that some form of waste management is now required, which provides further incentives for waste-to-energy conversion.

A common method of converting these waste materials is via “anaerobic digestion.” The product from anaerobic digestion is a “biogas” that can be used as a fuel to generate electricity, or burned directly for cooking, or for space and water heating.

Anaerobic digestion is the decomposition of wet and green biomass through bacterial action in the absence of oxygen that produces a mixed gas output of methane and carbon dioxide known as biogas. Biogas is most commonly produced using animal manure, mixed with water, which is stirred and warmed inside an air-tight container, known as a digester. Digesters range in size from one cubic yard for a small household unit to as large as 2000 cubic yards for a large commercial installation.

Background

There have been several bills considered in the recent past to provide a partial exemption for sales of agricultural-related equipment. These include:

AB 3089 (1993-94) which would have provided a five percent sales and use tax exemption with respect to tangible personal property purchased by new businesses engaged in the production of food, fiber, and other agricultural commodities. This bill failed passage in the Assembly Revenue and Taxation Committee.

AB 208 (1995-96), similar to AB 3089 above, was amended in the Assembly Revenue and Taxation Committee to delete the sales and use tax provisions.

AB 138 (1997-98), also similar to AB 3089 and AB 208, died in the Assembly Appropriations Committee.

SB 38 (1997-98) would have provided a five percent sales and use tax exemption to sales of implements of husbandry to new businesses engaged in agricultural production or agricultural services. This measure failed passage in the Senate Revenue and Taxation Committee.

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SB 818 (1999-00) would have provided a five percent state sales and use tax exemption for tangible personal property purchased by new businesses for use in post-harvesting activities of agricultural commodities. This measure failed passage in the Senate Revenue and Taxation Committee.

COMMENTS

- 1. Sponsor and purpose.** This bill is sponsored by the author. Its purpose is to provide an incentive to install self-sufficient, environmentally friendly energy or electricity producing equipment on California dairy farms. Specifically, the bill is intended to provide an exemption for purchases of “digesters” which convert animal manure into biogas. The biogas can produce enough energy to enable a farm to be self-sustaining, without drawing electricity from the power grid. The author also notes that although dairy manure is a valuable source of nutrients and organic matter for plant production, if incorrectly managed these same valuable nutrients can harm the environment by contaminating the air, water and soil. The installation of a digester on dairy farms would therefore enable a farmer to process the excess manure in an environmentally safe manner.
- 2. Bill should not be problematic to administer.** The bill proposes a limited exemption that would not materially affect the Board’s workload.

COST ESTIMATE

Some costs would be incurred in notifying affected retailers, verifying deductions on returns, and verifying claimed exemptions in audits. These costs are expected to be absorbable.

REVENUE ESTIMATE

Background, Methodology, and Assumptions

Based on discussions with a few major manufacturers of cogeneration systems, it is estimated that sales of such systems will be approximately \$100 million a year for the next couple of years.

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Revenue Summary

The revenue impact from exempting cogeneration systems used in dairy farms from the sales and use tax would be as follows:

	<u>Revenue Loss</u> <u>(in millions)</u>
State *(5.00%)	\$ 5.0
Local (2.25%)	2.3
Special District (0.67%)	<u>0.7</u>
Total	<u>\$ 8.0</u>

*The state sales and use tax rate will be 4.75% for calendar year 2001 and is scheduled to be 5% in calendar year 2002.

Qualifying Remarks

Discussions with some stakeholders revealed that interested companies, at this stage, might be involved in the very early stage of product development. We can assume that there might be several other companies that are planning to introduce their systems sometime in the future.

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